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No. 91-1229

In The

Supreme Court of the United States

October Term, 1991

UNITED STATES OF AMERICA, by and through INTERNAL REVENUE SERVICE,

Petitioner,

v.

BRUCE J. McDERMOTT and BETTY McDERMOTT, ZIONS FIRST NATIONAL BANK, N.A.,

Respondents.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit

BRIEF OF ZIONS FIRST NATIONAL BANK, N.A. IN OPPOSITION

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QUESTION PRESENTED

Whether a judgment lien of a private creditor that predates a federal tax lien has priority over the tax lien with respect to real property acquired by the debtor/taxpayer after the tax lien was filed.

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Respondent Zions First National Bank, N.A., through counsel, respectfully submits the following Brief in Opposition to the Petition for a Writ of Certiorari filed by the United States of America in this case.

OPINIONS BELOW

The Statement of Opinions Below and Jurisdiction supplied by the United States in this Petition accurately present the opinions of the lower courts and will not be

supplemented in this Brief. References to said opinions will be to those as included in the Appendix of the Petition of the United States.

STATUTORY PROVISIONS INVOLVED

1. 26 U.S.C. § 6321 provides:

   LIEN FOR TAXES.

   > If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

2. 26 U.S.C. § 6323(a) provides:

   PURCHASERS, HOLDERS OF SECURITY INTERESTS, MECHANIC'S LIENORS, AND JUDGMENT LIEN CREDITORS.

   > The lien imposed by section 6321 [Lien for Federal Taxes] shall not be valid as against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary.

3. Utah Code Annotated § 78-22-1 (1987 Repl.) provides:

   > From the time the judgment of the district court or circuit court is docketed and

> filed in the office of the clerk of the district court of the county it becomes a lien upon all the real property of the judgment debtor, not exempt from execution, in the county in which the judgment is entered, owned by him at the time or by him thereafter acquired during the existence of said lien. . . .

STATEMENT OF THE CASE

Prior to August 21, 1981, Bruce J. McDermott and Betty B. McDermott ("McDermott") were the owners of fee simple title to a certain parcel of real property located in Salt Lake City, Utah (hereinafter the "Property"). On or about August 21, 1981, McDermott as "Seller", entered into a Uniform Real Estate Contract with third parties, as "Buyer" for the sale and purchase of the Property. To secure in part the Buyer's obligation under the Uniform Real Estate Contract, McDermott accepted from the Buyer a Trust Deed Note and a Trust Deed on the Property securing said Note with Buyer's interest in the Property, notwithstanding the fact that legal title to the Property remained vested in McDermott. (R. 4, ¶¶ 1-3).

On June 22, 1987, a Judgment was entered in the Third Judicial District Court of Salt Lake County, State of Utah, against McDermott and in favor of Zions First National Bank ("Zions") in the amount of $67,977.67 together with post-judgment interest and attorneys fees, which Judgment was duly docketed on July 6, 1987 in Book 213 as Entry No. 2402. (R. 6, ¶ 2 and Exhibit "A" attached thereto).

On September 9, 1987, a Notice of Federal Tax Lien Under Internal Revenue Service was filed with the Salt Lake County Recorder's Office alleging an unpaid tax liability of McDermott in the amount of $103,657.93. (R. 4, ¶ 5).

As a result of an eventual breach of Buyer's default in the payment obligations of the Uniform Real Estate Contract and the Trust Deed Note, McDermott commenced a power of sale foreclosure on the Property, the actual Trustee's Sale for which occurred on September 23, 1987. The high bidder at the Trustee's Sale was McDermott, who repurchased the Property. (R. 4, ¶¶ 6-7).

During the last three months of 1987, negotiations were pursued between Zions and the United States of America through the Internal Revenue Service ("IRS") concerning the respective priorities of their competing lien claims against the Property and potential proceeds therefrom. An Escrow Agreement was prepared by counsel for McDermott to memorialize the ultimate agreement between Zions and the IRS providing a consensual ordering of the priorities of the respective lien claims as applicable to the proceeds. (R. 12, ¶¶ 3, 7-11). The final Escrow Agreement, dated March 4, 1988, and executed by McDermott, Zions and the IRS, contains the following negotiated language:

> The respective priorities of the parties to the cash proceeds shall be identical to the priorities of the respective liens of the parties as they existed against the real property as of September 23, 1987, after Bruce J. McDermott successfully bid and purchased the property at the

> Trustee's Sale, notwithstanding the change in form of collateral.

McDermott sold the Property to an independent party on or about March 4, 1988, the net proceeds of which totaling $135,575.50 were paid into the Third District Court of Salt Lake County, State of Utah, concurrently with the filing of a Complaint for Interpleader by McDermott commencing this action. (R. 4, ¶¶ 8-9).

The suit was removed from the state court to the United States District Court for the District of Utah on motion of the IRS. (R. 1). Zions and the IRS thereafter filed Motions for Summary Judgment, each asserting that it was entitled to satisfy its lien from the proceeds first. (R. 3 and 7). In its Memorandum Decision and Order, dated January 17, 1989, granting summary judgment in favor of Zions, the Honorable J. Thomas Greene held that the Escrow Agreement had reordered the priorities of the competing liens as against the proceeds to be identical to the respective priorities of the liens as they existed against the real property immediately following the Trustee's Sale. The District Court further held that between the two simultaneously attaching liens, Zion's judgment lien enjoyed a priority over the IRS tax lien because of its earlier date of docketing. (R. 21).

Pursuant to an appeal by the IRS, the Tenth Circuit Court of Appeals reviewed and upheld the decision of the district court. The Court found that the Escrow Agreement had consensually resolved any issues as to the nature of the property subject of the liens. It further held that Zions' judgment lien had obtained cohate status prior to the filing of the tax lien and thus was entitled to

priority as to the proceeds from the sale of the Property. The fact that the specific Property was obtained subsequent to the perfection of both the judgment lien and the tax lien did not affect the cohate character of those liens which, being general in nature, applied to *all* of McDermott's real property located in Salt Lake County.

REASONS FOR DENYING THE PETITION

The Tenth Circuit affirmed the district court decision, holding that a judgment creditor's claim has priority under federal law over a subsequently filed federal tax lien on real property acquired by the debtor/taxpayer subsequent to the attachment of both the judgment lien and the tax lien. Contrary to the assertions of the IRS, this holding is consistent with the only other federal appeals court decision on the issue, *Southern Rock, Inc. v. B & B Auto Supply*, 711 F.2d 683 (5th Cir. 1983) as well as every reported decision by the federal district courts since 1978. *McAllen State Bank v. Saenz*, 561 F. Supp. 636 (S.D. Tex. 1982); *State of Wisconsin v. Bar Coat Blacktop, Inc.*, 640 F. Supp. 407 (W.D. Wis. 1986); *United States v. Fleming*, 474 F. Supp. 904 (S.D.N.Y. 1979).

Although potentially significant to the IRS for its administrative impact, this case has now twice been decided in accordance with well accepted federal and state law. Together with the decision of *Southern Rock, supra*, the Tenth Circuit opinion stands as a well-defined standard for the determination of priorities of conflicting liens with respect to after-acquired real property of a debtor/taxpayer.

The competing lien claims of Zions and the IRS are based upon separate and distinct authorities. The judgment lien claimed by Zions attaches to all real property owned by the judgment debtor upon its docketing. Pursuant to Utah Code Ann. § 78-22-1 (1953, as amended), the Utah State Supreme Court has unfailingly held that the docketing of the judgment is the act which creates the lien. *Orton v. Adams*, 21 Utah 2d 245, 444 P.2d 62, 63 (1968). Further, that court has declared that "a judgment automatically becomes a lien upon all nonexempt real property of the debtor at the time it is docketed." *Taylor National, Inc. v. Jensen Brothers Construction Company*, 641 P.2d 150, 155 (Utah, 1982). The definition of "judgment lien creditor" as used in 26 U.S.C. § 6323(a) is set forth in 26 CFR § 301.6323(h)-1(g) and undisputedly includes the judgment lien of Zions as docketed.

The federal tax lien claimed by the IRS may attach to all real *and* personal property of the delinquent taxpayer pursuant to 26 U.S.C. § 6321. Although effective as of the date of the tax assessment, the priority of the tax lien is based upon the date that the Notice thereof is filed with the appropriate county recorder. In this matter, the only property being claimed by the IRS under its tax lien is all of the real property located in Salt Lake County and owned by the delinquent taxpayer -- the identical property claimed by Zions.

As a general rule, the first lien of record against a debtor's property has priority over those subsequently filed unless a lien-creating statute clearly shows or declares an intention to cause the statutory lien to override. This principle has been paraphrased as the universal rule of "first in time is the first in right." *United States v.*

City of New Britain, 347 U.S. 81, 85 (1954); *Merger v. United States*, 375 U.S. 233 (1963).

Federal law determines the priority between federal tax liens and state created liens. *United States v. Equitable Life Assurance Society of the United States*, 384 U.S. 323, 328 (1966). Under Section 6323(a) of the Internal Revenue Code, judgment lien creditors are granted priority over federal tax liens when the judgment lien is perfected and "cohate" prior to the filing of the Notice of Tax Lien. *United States v. City of New Britain*, 347 U.S. 81, 85-86 (1954). Whether or not a judgment lien is cohate is also a federal question. *United States v. Security & Savings Bank, Executor*, 340 U.S. 47, 49-50 (1950). This Court has required "the identity of the lienor, the property subject to the lien, and the amount of the lien" to be established in order for the lien to be classified as "cohate." *City of New Britain*, 347 U.S. at 84. This same requirement has been adopted into the IRS regulations for purposes of the applying 26 U.S.C. § 6323(a).

The parties to this action stipulated that their respective claims to the proceeds would be determined by their respective priority claims as against the Property upon purchase of same by McDermott at the Trustee's Sale. Zions' judgment lien had, on July 6, 1987, become cohate in that the amount of the lien, the identity of the debtor, and the fact that the lien was fixed upon all real property located in Salt Lake County, had been determined. Similarly, the IRS tax lien became perfected on September 9, 1987 as to all real property owned by McDermott. The nature of McDermott's interest in the Property was only personalty until their purchase at the Trustee's Sale on

September 23, 1987 at which time they acquired the Property reuniting the legal and equitable interests. At that moment, pursuant to the express terms of the Escrow Agreement, both the IRS tax lien and Zions judgment lien immediately and simultaneously attached specifically to the Property.

The issue of priority of liens simultaneously attaching to after-acquired property of a debtor has resulted in an evolution of the law through continued analysis over the past 41 years. Resort to the Tax Code is not fruitful. "Section 6323 certainly was not enacted to decide dead heats among racing lien holders." *Texas Oil & Gas Corporation v. United States*, 466 F.2d 1040, 1052 (5th Cir. 1972), *cert. denied*, 410 U.S. 929 (1973).

First discussed theoretically in *United States v. Graham*, 96 F. Supp. 318 (S.D. Cal. 1951), *aff'd sub nom, California v. United States*, 195 F.2d 530 (9th Cir. 1952), *cert. denied*, 344 U.S. 831 (1952), the analysis was prefaced by that court's remarks: "The determination of this question is not necessary to the decision in this case." However "assuming arguendo" that the claimant competing with the federal tax lien had a valid lien, the court surmised without citation to any authority, that a federal tax lien would be superior to any simultaneously attaching interest of another party. 96 F. Supp. at 321. *Graham* was thereafter cited with approval, again in dictum and without statutory or other authority, in the other cases cited by the IRS in support of its Petition. *United States v. Meyer*, 346 F. Supp. 554 (S.D.N.Y. 1972); and *MDC Leasing Corp. v. New York Property Insurance Underwriting Association*, 450 F. Supp. 179, 181 (S.D.N.Y. 1978). In both of these

New York cases, the court actually found that the claimant competing with the federal tax lien had failed to perfect its lien and was therefore subordinate and junior to the IRS. Resolution of the ultimate issue of simultaneous attachment was not necessary.

The first known reported case to wrestle with the issue directly was *Iowa Fair Plan v. United States*, 257 N.W.2d 626 (Iowa 1977). There, in a five to four split decision, the court held that because a first-filed state lien attached simultaneously with a federal tax lien on after-acquired property of the borrower, it failed to become cohate "before the tax lien." *Id.* at 629. Accordingly, it presented the federal tax lien with super-priority without any cite to statutory authority for the elevating decree.

The next discovered case on point began the movement to analyze the respective rights of the competing lien claimants in light of statutory and case law precedent. In *United States v. Fleming*, 474 F. Supp. 904 (S.D.N.Y. 1979), various state, city and federal tax liens were filed against the taxpayer, all prior to their purchase of certain personal property. By statute, each of the tax liens covered after-acquired property. The IRS argued that based on the dicta of *Graham*, the IRS should receive priority status notwithstanding the simultaneous attaching of the tax liens upon the purchase by Fleming of the property. The same court which had previously cited *Graham* favorably, now disapproved of its sweeping reasoning, limited it to its facts, and declared that the state liens enjoyed an equal footing with the IRS liens.

The Federal District Court in Texas made the earliest comprehensive analysis of the issue in *McAllen State Bank*

v. Saenz, 561 F. Supp. 636 (S.D. Tex. 1982). In a case remarkably similar to the present matter, that court was required to determine the relative priorities of a federal tax lien and a judgment lien to the proceeds of a foreclosure sale of after-acquired real property. As is the law in Utah, a judgment lien in Texas is perfected as to all real property situated in the county in which the judgment is indexed or docketed. After recognizing that both judgment and tax liens attach to after-acquired property, and deciding that the competing liens were both cohate and properly perfected, the court acknowledged that "the priority of competing liens on which there is a federal tax lien is determined by federal law. *Aquilino v. United States*, 363 U.S. 509, 80 S. Ct. 1277 (1960)." 561 F. Supp. at 639. *Graham* was discarded on its facts with no deference to its dicta. *Fleming* was cited as being in accord with Texas law. But inasmuch as the determination of tax lien priorities is governed by federal law, the federal rule of "first in time, first in right" required the court to order the first payment of proceeds to the first lien of record even though both lien claimants preceded the purchase of the property by the debtor. This holding "encourages the diligent filing of liens [even by the IRS] whether or not after-acquired property is involved." *Id.* at 640.

Taking the opportunity to review the relevancy and reliability of many of the above-cited cases, the court encountered the same issue in *State of Wisconsin v. Bar Coat Blacktop, Inc.*, 640 F. Supp. 407 (W.D. Wis. 1986). Narrowly limiting *Graham* and its progeny to their specific facts, the court rejected the notion that on the issue of simultaneously attaching liens, "tie goes to the federal government." 640 F. Supp. at 414. Finding "no legal or

policy reason that would mandate a deviation" from the *McAllen State Bank* rule, the Court ordered that the funds on deposit be paid as against the pre-acquisition liens in the order of their perfection.

Southern Rock, Inc. v. B & B Auto Supply, 711 F.2d 683 (5th Cir. 1983) is the only other known federal appeals case wherein the Court directly addressed the issue of competing lien claims including federal tax liens which attached simultaneously to after-acquired property of a debtor. The Fifth Circuit Court refused the rule of *MDC Leasing, supra*, that any competing lien simultaneously attaching with the tax lien lacked cohateness prior to attachment and was therefore inferior.

> In our view, another aspect of cohateness that no longer floats, although concededly not specifically addressed by § 6323, is the notion that a tie goes to the government. To the extent that the purpose of the Federal Tax Lien Act was to conform tax liens to Article 9 security interests, the way to achieve this goal is to treat the government like any other creditor. Giving the government's filed tax lien priority over a simultaneously recorded security interest would defeat this goal. We do not believe that is what Congress intended.

711 F.2d at 689. The Court there recognized the evolution in the courts which has removed the unauthorized super-priority demanded by the IRS in favor of a treatment of lien claims on equal footing.

In its Petition, the IRS asserts that *Southern Rock* represents a third option in dealing which simultaneous attaching cases - that the competing claimants should

share *pro rata* in the proceeds of the Property. A careful reading of the case shows that the reason for the *pro rata* distribution was its inability to determine which of the competing claims had in fact attached first. "[W]e are left with a simultaneous filing and must decide who wins when the race to the courthouse ends in a tie." 711 F.2d at 688. Such is not the case in the instant matter.

The present case, most factually similar to *McAllen State Bank*, was properly resolved below in conformance with that opinion as confirmed by *Bar Coat Blacktop*. Zions' judgment lien was cohate and perfected as to all real property then and thereafter owned by McDermott at the date of docketing. Nothing further was required of Zions to attach the lien on after-acquired property. Utah Code Annotated § 78-22-1 (1987 Repl.). Likewise, the federal tax lien was cohate and perfected as to all real property then or thereafter owned by McDermott as of September 9, 1987. *Glass City Bank of Jeanette, Pa. v. United States*, 326 U.S. 265, 66 S. Ct. 108 (1945). Attaching to the Property simultaneously, the federal rule of "first in time, first in right" must apply. Zions' lien was properly accorded priority over the IRS's subsequently filed lien. *United States v. City of New Britain*, 347 U.S. 81 (1954).

Other than a single 15 year-old state court decision and a short line of federal district court cases apparently abandoned in favor of a better reasoned approach based on the doctrine of cohateness, there exists no reason for this Court to reopen an issue which has been the subject of agreement by the Fifth and Tenth Circuits.

CONCLUSION

Based on the foregoing analysis, the Court should deny IRS' Petition for a Writ of Certiorari.

Respectfully submitted this 16th day of April, 1992.

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